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Date:

July 22, 2013

Re:

Legend:

Grantor	=
Spouse	=
Child 1	=
Child 2	=
Child 3	=
Child 4	=
Trust	=
Individual Co-Trustee	=
Bank	=

Court	=
State	=
State Statute	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
X	=

Y =
Z =

Dear :

This responds to your personal representative's letter of November 26, 2012, requesting rulings as to the generation-skipping transfer (GST), estate, gift, and income tax implications of the proposed modification to an irrevocable trust.

The facts submitted and the representations made are as follows. As of Year 1 (a year prior to 1986), Grantor and Spouse were husband and wife and had four children, Child 1, Child 2, Child 3, and Child 4 (collectively, Children). On Date 1, in Year 1, Grantor formed an irrevocable trust (Trust). It has been represented that Spouse and Individual Co-Trustee were the co-trustees of Trust.

Section 3.1 of Trust provides that the trustees have the discretion to distribute income to Spouse and Children. There is no duty to equalize distributions and Spouse's welfare is the paramount consideration in making such distributions. Income not distributed is added to principal. Prior to Grantor's death, the trustees may not distribute income to Spouse without the consent or approval of a party who would be considered an adverse party for purposes of § 677 of the Internal Revenue Code.

Section 3.2 provides that the trustees can distribute principal to Spouse and Children to provide for their support, maintenance, and education after taking into consideration the income and other resources known to the trustees to be available to them. There is no duty to equalize payments and Spouse's welfare is the paramount consideration in making such distributions. Prior to Grantor's death, the trustees may not distribute principal to Spouse without the consent or approval of a party who would be considered an adverse party for purposes of § 677.

Section 3.3 provides that after the death of the last to die of Grantor and Spouse, or at such earlier time as the trustees in their discretion may determine, the trustees are to divide Trust into equal shares, one share for each of Grantor's then living children and one share for each deceased child of Grantor who has then living issue.

Section 3.311 provides that the trustees have the discretion to distribute income to the child for whom the trust share was established and that child's issue. There is no duty to equalize payments and the welfare of the child for whom the trust was established is the paramount consideration for making such distributions.

Section 3.312 provides that the trustees may distribute principal to the child and that child's issue whenever the trustees determine that the income and other resources known to the trustees to be available to the child and issue are not sufficient for their reasonable support, maintenance, and education (including, but not limited to, the

purchase or improvement of a home for the child that is commensurate with the child's income and standard of living). There is no obligation to equalize payments among beneficiaries and the child's welfare is the paramount consideration in making such distributions.

Section 3.313 provides that the child has a testamentary limited power to appoint the remaining balance of his or her trust share to the child's spouse and Grantor's then living issue. Property not appointed is to be distributed to the child's then living issue, by right of representation; or, if the child has living no issue, to Grantor's then living issue, by right of representation, provided that if any of the issue is an income beneficiary of a trust share established under Trust the property is to be contributed to that trust share.

Section 3.32 provides that the trustees will distribute a trust share created for a deceased child who has issue as directed by the deceased child's testamentary power of appointment among the deceased child's spouse and Grantor's living issue. Property not appointed is to be distributed to the deceased child's then living issue by right of representation.

Section 3.33 provides that notwithstanding section 3.32, if during Spouse's lifetime the trustees divide Trust into trust shares for the benefit of Grantor's issue the following shall apply. Section 3.331 provides that if the trustees determine that the income and other resources known to the trustees to be available to Spouse is not sufficient for her reasonable support and maintenance (taking into consideration her standard of living as of the date of Grantor's death), the trustees may pay Spouse so much of the principal and income of the trust shares created for Grantor's living children as the trustees in their discretion determine to be required for those purposes. Each such trust share is required to contribute an equal amount toward such payments.

Section 3.44 provides that if Spouse and all of Grantor's issue die prior to the final distribution of Trust, then 25 percent of Trust is to be distributed pursuant to Spouse's limited power of appointment. Property not appointed is to be distributed in equal shares to the then living members of a group of eight named individuals.

Section 6.4 provides that Grantor's purpose in creating Trust is to conserve trust principal and achieve savings in income and death taxes. If, however, the trustees determine that changes in the tax laws or other circumstances would frustrate this purpose, or that the corpus of Trust or a trust share is insufficient to justify the continuance of Trust or a trust share, the trustees can terminate Trust or a trust share and distribute the assets to the then income beneficiaries by right of representation. The trustees cannot make distributions to Spouse in termination of Trust unless they receive the consent or approval of a party who would be considered an adverse party to her within the meaning of § 672.

Section 8.1 provides that a trustee cannot exercise or join in the exercise of any power to terminate any trust if a distribution in termination would be made to the trustee nor can a trustee exercise or join in the exercise of any power to pay over, use, or apply the principal or income of any trust for his own benefit or for the benefit of any person whom he has a then existing legal obligation to support.

Section 9.1 provides that if Spouse is unable or unwilling to continue to act as a co-trustee, Spouse may appoint a successor co-trustee in her place or in the place of any successor co-trustee she may have appointed who is unable or unwilling to act or to continue to act as a co-trustee. If Spouse fails to appoint a successor co-trustee and such failure continues for a period of 90 days, at the conclusion of the 90 day period Bank shall act as successor co-trustee or sole trustee.

Section 9.2 provides that if Individual Co-trustee is unable or unwilling to act as co-trustee Spouse may appoint a successor co-trustee in his place or in the place of any successor co-trustee she may have appointed who is unable or unwilling to act or to continue to act as co-trustee. If Spouse fails to appoint a successor co-trustee and such failure continues for a period of 90 days, at the conclusion of the 90 day period, Bank shall act as successor co-trustee or sole trustee.

Section 9.3 provides that after the division of Trust into trust shares and after a child has attained the age of 30 years the child shall act as co-trustee of his or her share with Individual Co-trustee. If a child is unable or unwilling to act as co-trustee, the child may appoint a successor co-trustee. If the child fails to appoint a successor co-trustee and such failure continues for a period of 90 days, at the conclusion of the 90 day period, Bank shall act as successor co-trustee or sole trustee. However, if Individual Co-Trustee is unable or unwilling to act or to continue to act as co-trustee, the child may appoint a successor co-trustee. If the child fails to appoint a successor co-trustee and such failure continues for a period of 90 days, at the conclusion of the 90 day period, Bank shall act as successor co-trustee or sole trustee.

Section 9.4 provides that Spouse (and, after Spouse's death, a child for whom a trust share is established) can remove any corporate fiduciary then acting as trustee which has its principal place of business in a state other than the state in which Spouse (or child) is domiciled and appoint as a trustee or co-trustee a corporate fiduciary which has its principal place of business in the state in which Spouse (or child) is then domiciled.

Section 9.5 provides that if Bank is unable or unwilling to act as trustee, Spouse, (or if she is dead, Grantor's issue who are then income beneficiaries of such trust share by majority vote) may appoint an individual or corporate fiduciary as successor trustee in its place.

On Date 1, in Year 1, Grantor funded Trust with stock in a closely held company. On Date 2, in Year 1, Grantor contributed to Trust stock in another closely held company. It has been represented that all of the stock Grantor contributed to Trust was, on the dates of contribution, Grantor's sole and separate property and not marital property under the laws of State.

Grantor and Spouse were divorced in Year 2 (a year before 19). In Year 3, Spouse executed an instrument resigning as co-trustee of Trust effective Date 3 (a date after October 22, 19). In addition, in the instrument, Spouse declined to exercise her right under Section 9.1 of Trust to appoint a successor co-trustees.

Subsequent to Grantor and Spouse's divorce, Spouse executed a disclaimer on Date 3. Date 3 is more than 9 months after Date 1 (the date Spouse's interests in Trust were created). The disclaimer provided that she irrevocably renounced, disclaimed, relinquished, and released any and all beneficial income and principal interest and special powers of appointment which she may now have or which she may otherwise hereafter acquire in and to Trust (specifically citing her discretionary income and principal interests and special power of appointment under Sections 3.1, 3.2, 3.331 and 3.44 of Trust). It has been represented that trustees have never made a distribution of income or principal to Spouse since Trust's establishment through the date of the disclaimer. It has been represented that Spouse's disclaimer was effective under State law.

On Date 4, the Court entered an order accepting Spouse's and Individual Co-Trustee's resignation as trustees and approving the appointment of Bank and Child 1 as successor co-trustees. The Date 4 Court Order provided that the successor co-trustee to Child 1 was Child 4; the successor co-trustee to Child 4 was Child 3; and the successor co-trustee to Child 3 was Child 2. The order also confirmed Spouse's disclaimer.

Some years later in Year 4, a dispute arose between Child 2 and Bank as to whether Trust had been or should now be divided into four separate trusts pursuant to Section 3.3 of Trust and as to the identity of the co-trustees of the four separate trusts. On Date 5, Bank filed a petition with Court to resolve these issues. After considerable negotiation, the parties entered into a settlement agreement. On Date 6, Court issued an order approving the settlement agreement, subject to the issuance of a private letter ruling from the Internal Revenue Service.

The terms of the settlement agreement are as follows. Trust is to be divided pursuant to Section 3.3 of Trust into four equal separate trusts, one for each of Grantor's children. Each child's trust is to be further divided into two separate trusts, Trust A and B. The terms of Trust A and B are identical, except as to the identity of the corporate co-trustee. Once a year, each child (in his or her individual capacity) may request that the corporate trustee of his or her separate Trust A transfer up to \$X from

Trust A to Trust B. The \$X amount shall not include any stock in a closely held company. The transfer will consist first of income and then principal.

Upon the earlier to occur either Y years from the effective date of the settlement or the date of Grantor's death, each child may transfer from the child's Trust A to the child's Trust B all of the remaining assets of the child's Trust A, other than stock in a closely held company.

During Grantor's lifetime, so long as a child's Trust A owns stock in a closely held company, the stock cannot be transferred to the child's Trust B. If the stock is liquidated during Grantor's lifetime but after Y years from the effective date, each child may transfer from the child's Trust A to the child's Trust B all the remaining assets in Trust A any time after the stock's liquidation.

Upon and after Grantor's death, any stock in a closely held company owned by a child's Trust A shall continue to be held in the child's Trust A, until the earlier to occur of the Z-year anniversary of Grantor's death or the liquidation of the stock (the final transfer date). Upon the final transfer date, each child may transfer all the remaining assets of the child's Trust A, including any stock in a closely held company, to the child's Trust B.

If a child dies prior to the final transfer date, and the child exercised the special power of appointment under Section 3.313 of Trust, the exercise must comply with the two preceding paragraphs above. If a child dies without exercising the power of appointment, the trustee is to distribute the remaining assets of the child's Trust A and B pursuant to Section 3.313 of Trust.

At all times there shall be a corporate trustee of the Trusts A and B. Bank is the corporate trustee of all Trusts A. Bank cannot be removed as co-trustee except as provided under State law. If Bank resigns or is removed, the child for whom the Trust A was established can appoint a successor corporate trustee.

The child for whom a Trust B has been created may select the corporate trustee for that child's Trust B. The child can remove this corporate trustee. If the corporate trustee resigns or is removed, the child can appoint a successor corporate trustee.

The following rulings have been requested:

1. The division of Trust into separate trusts, and the division of the separate trusts into separate Trusts A and B, a child's exercise or failure to exercise a transfer right, and the other proposed modifications to Trust set forth in the settlement agreement will not cause any distribution from or termination of any interest in Trust, the separate trusts, or the separate Trusts A and B, to be subject to GST tax under § 2601.

2. The division of Trust into separate trusts, the division of the separate trusts into separate Trusts A and B, a child's exercise or failure to exercise a transfer right, and, the other proposed modifications to Trust set forth in the settlement agreement will not constitute transfers subject to federal gift tax.

3. The division of Trust into separate trusts, the division of the trusts into separate Trusts A and B, a child's exercise or failure to exercise a transfer right and the other proposed modifications to Trust set forth in the settlement agreement will not cause any assets of Trust, the separate trusts, or the separate Trusts A or B to be included in the gross estate of any beneficiary or Grantor.

4. The division of Trust into separate trusts, the division of the separate trusts into separate Trusts A and B, a child's exercise of a transfer right, and the other proposed modifications to Trust set forth in the settlement agreement will not cause Trust, any separate trust, any separate Trust A or B, or any beneficiary to recognize any gain or loss from a sale or other disposition of property under § 61 or § 1001.

5. The proposed modifications to Trust set forth in the settlement agreement will result in separate Trust A holding assets with the same basis such assets had in Trust and will result in a holding period for all the assets allocated to a separate Trust A that include Trust's holding period under § 1223 and, following the transfer of assets from a separate Trust A to a separate Trust B, such Trust B's basis in the transferred assets will be the same as the basis such assets had in Trust A and will result in a holding period for such transferred assets that include Trust A's holding period.

6. Each of the separate Trusts A and B will be treated as a separate trust for federal income tax purposes.

Law and Analysis

Ruling 1

Section 2501(a) imposes a gift tax for each calendar year on the transfer of property by gift during the year by an individual.

Section 2511 provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.

Section 2518 provides that, if a person makes a qualified disclaimer with respect

to any interest in property, the disclaimed interest will be treated for gift, estate, and GST tax purposes as if the interest had never been transferred to such person.

Section 2518(b) provides that a “qualified disclaimer” means an irrevocable and unqualified refusal by a person to accept an interest in property, but only if: (1) the disclaimer is in writing; (2) the disclaimer is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is nine months after the later of (A) the date on which the transfer creating the interest in the person is made, or (B) the day on which the person attains age 21; (3) the person has not accepted the interest or any of its benefits; and (4) as a result of the disclaimer, the interest passes without any direction on the part of the person making the disclaimer and passes either to the decedent's spouse or to a person other than the person making the disclaimer.

Section 25.2518-2(c)(1) of the Gift Tax Regulations provides that a disclaimer is a qualified disclaimer only if the writing described in § 25.2518-2(b)(1) is delivered to the persons described in § 25.2518-2(b)(2) no later than the date which is 9 months after the later of--(i) the date on which the transfer creating the interest in the disclaimant is made, or (ii) the day on which the disclaimant attains age 21.

Section 2601 imposes a tax on every generation-skipping transfer made after October 22, 1986.

Section 2611(a) provides that the term “generation-skipping transfer” means a tax distribution, a taxable termination, and a direct skip.

Section 2642(a)(3)(B) provides that the term “qualified severance” means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of two or more trusts if--(I) the single trust was divided on a fractional basis, and (II) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

Section 2652(a) provides that in the case of any property subject to the tax imposed by chapter 12 the term “transferor” means the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 26.2652-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor. Thus, an individual may be a transferor even though there is no transfer of property under local law at the time the Federal estate or gift tax applies.

Section 26.2652-1(a)(2) provides that a transfer is subject to federal gift tax if a gift tax is imposed under § 2501(a) (without regard to exemptions, exclusions, deductions, and credits).

Under § 1433 of the Tax Reform Act of 1986 (the Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985 to a trust which was irrevocable on September 25, 1985, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the GST tax provisions. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to the GST tax and a portion subject to the GST tax. The non-chapter 13 portion represents the value of all assets of the trust as it existed on September 25, 1985. The applicable fraction (as defined in § 2642(a)(2)) for the non-chapter 13 portion is deemed to be one and the inclusion ratio (as defined in § 2642(a)(1)) is zero. The chapter 13 portion of the trust represents the value of all additions to the trust made after September 25, 1985. The inclusion ratio of the chapter 13 portion is determined under § 2642.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if--(1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

Section 26.2602-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, considers a situation in which, in 1980, Grantor established an irrevocable trust for the benefit of his two children, *A* and *B*, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to *A*, *B*, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of *A* and *B*, the trust principal is to be distributed to the living issue of *A* and *B*, *per stirpes*. In 2002, the appropriate State Court approved the division of the trust into two equal trusts, one for the benefit of *A* and *A*'s issue and one for the benefit of *B* and *B*'s issue. The trust for *A* and *A*'s issue provides that the trustee has the discretion to distribute trust income and principal to *A* and *A*'s issue in such amounts as the trustee deems appropriate. On *A*'s death, the trust principal is to be distributed equally to *A*'s issue, *per stirpes*. If *A* dies with no living descendants, the principal will be added to the trust for *B* and *B*'s issue. The trust for *B* and *B*'s issue is identical (except for the beneficiaries), and terminates at *B*'s death at which time the trust principal is to be distributed equally to *B*'s issue, *per stirpes*. If *B* dies with no living descendants, principal will be added to the trust for *A* and *A*'s issue. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(E), Example 10, considers a situation in which, in 1980, Grantor executed an irrevocable trust for the benefit of grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for

in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13.

In the present case, Trust was irrevocable on September 25, 19 . After this date, however, Spouse executed a disclaimer that was effective under State law to terminate her interests in Trust. Spouse executed this disclaimer more than 9 months after Date 1, the date Spouse acquired interests in Trust. Spouse's interests in Trust consisted of the right to income and principal distributions, a limited power to appoint trust assets, and the power to name successor trustees. We express no opinion as to the fair market value of these rights or powers for federal gift tax purposes. Based upon the facts submitted and the representations made, we conclude that Spouse made a gift to Children on Date 3 when she disclaimed her interests in Trust. As a result of Spouse's gift, Spouse is the transferor for GST tax purposes of a portion of Trust equal to the fair market value of Spouse's gift determined under § 2512. The remaining portion of Trust is GST exempt because Trust was irrevocable prior to October 22, 19 .

With respect to the proposed modifications to Trust set forth in the settlement agreement, the proposed divisions of Trust are similar to the division described in Example 5 of § 26.2601-1(b)(4)(i)(E). The proposed trustee modifications to Trust set forth in the settlement agreement are administrative in nature. See Example 10 of § 26.2601-1(b)(4)(i)(E). Finally, the proposed transfer of assets from Trust A to Trust B, though not a qualified severance, is similar to a qualified severance described in § 2642(a)(3) in that the terms of the trust acquiring the assets are the same as the originating trust. The beneficiaries' right to and power over the trust assets has not changed. Assets are merely placed in a trust with the same terms as the original trust but with a different corporate co-trustee.

In addition, the facts provided and representations made indicate that the proposed modifications to Trust set forth in the settlement agreement represent a compromise between the positions of the litigating parties and reflect the parties' assessments of the relative strengths of their positions. These facts and representations indicate that the settlement is the product of arm's length negotiations and is within the range of reasonable outcomes under Trust's terms and applicable State law.

Accordingly, based upon the facts submitted and the representations made, we conclude that the division of Trust into separate trusts, and the divisions of the separate trusts into separate Trusts A and B, a child's exercise or failure to exercise a transfer right, and the other proposed modifications to Trust set forth in the settlement agreement will not cause any distribution from or the termination of any interest in the portion of Trust, the separate trusts, or the separate Trusts A and B that is GST exempt to be subject to GST tax under § 2601.

Ruling 2

Section 2501 imposes a tax on the transfer of property by gift during the calendar year by any individual.

Section 2511 provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

In this case, the proposed modifications to Trust set forth in the settlement agreement do not increase, decrease, or otherwise change any beneficiary's beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, we conclude that the division of Trust into separate trusts, the divisions of the separate trusts into separate Trusts A and B, a child's exercise or failure to exercise a transfer right, and the other proposed modifications to Trust set forth in the settlement agreement will not constitute transfers subject to federal gift tax.

Ruling 3

Section 2035(a) provides that if (1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under § 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of the decedent's death, the value of the gross estate shall include the value of any property (or interest therein) that would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death -- (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a

reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or in conjunction with any other person (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Section 20.2038-1(a)(2) of the Estate Tax Regulations provides that § 2038 does not apply to a power that a decedent has under local law that can only be exercised with the consent of all parties having an interest in the transferred property.

State Statute provides that a trust or any part thereof may be revoked, modified, or terminated by written consent of the settlor and all beneficiaries of a trust or any part thereof.

In this case, the proposed modifications to Trust set forth in the settlement agreement do not increase, decrease, or otherwise change any beneficiary's beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, the division of Trust into separate trusts, the divisions of the trusts into separate Trusts A and B, a child's exercise or failure to exercise a transfer right, and the other proposed modifications to Trust set forth in the settlement agreement will not cause any assets of Trust, the separate trusts, the separate Trusts A or B to be included in the gross estate of any beneficiary or Grantor.

Rulings 4 and 5

Section 61(a)(3) provides that gross income includes gain derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property

for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained. An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges. Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. See Rev. Rul. 69-486, 1969-2 C.B. 159 (pro rata distribution of trust assets not a sale or exchange).

Here, Trust's assets will be distributed in kind on an equal basis among the four separate trusts. Because the transfer of assets from Trust to each separate trust will be made under the express authority granted to the trustees under the terms of the trust document, the beneficiaries do not acquire their interest in their respective separate trust as a result of the exchange of their interests in Trust, but instead by reason of the exercise of the trustees' existing authority to divide Trust.

In addition, the further division of each separate trust into separate Trusts A and B is not an exchange because each child continues to hold all of the interest in the assets of their respective separate trust before and after the division.

Accordingly, based upon the facts submitted and the representations made, we conclude that the severance of Trust and further division of each separate trust will not result in the realization of gain or loss under §§ 61 and 1001. Each asset of Trust will have the same basis and holding period in the hands of each separate Trust A and B as that asset had in the hands of Trust. Because no exchange is taking place, § 1223 does not apply.

Ruling 6

Section 643(f) provides that under regulations prescribed by the Secretary, two or more trusts shall be treated as one trust if (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) the principal purpose of such trusts is the avoidance of the tax imposed by chapter 1.

Section 1806(b) of the Tax Reform Act of 1986 provides that in the case of a trust which was irrevocable on March 1, 1984, § 643(f) shall apply only to that portion of the trust which is attributable to a contribution to corpus after March 1, 1984.

Accordingly, based on the facts submitted and the representations made, we conclude that as long as each separate Trust A and separate Trust B created by the

division of Trust are each separately managed and administered, they will each be treated as separate trusts for federal income tax purposes.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Leslie H. Finlow

Leslie H. Finlow
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Associate Chief Counsel
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Enclosures:
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